

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

TRIAL BRIEF OF ASSOCIATION FOR POSTAL COMMERCE

The Association for Postal Commerce (PostCom) submits this trial brief in accordance with the schedule established in POR R2000-1/71. The testimony sponsored by PostCom is critical of several elements of the case presented for the Postal Service, though largely supportive of the rates proposed.

Lawrence G. Buc, in testimony sponsored by an array of participants including PostCom (DMA-T-1), argues on several grounds that the Postal Service has very substantially overstated the revenue requirement for the Test Year. The core of Mr. Buc's testimony is that the contingency fund requested by the Postal Service is very substantially overstated.

An ancillary foundation for the Buc revenue requirement testimony is what witness Buc characterizes as "an error in the AFSM 100 cost reduction estimate", DMA-T-1-19-23. This notion is expanded on by PostCom witnesses Sander A. Glick (PostCom et al. -T-1) to serve as a basis for Mr. Glick's conclusion that the automation rates proposed by the Postal Service are appropriate but represent a considerably smaller passthrough of actual cost savings than presented in Postal Service testimony. Mr. Glick's conclusions concerning the understatement of automation cost savings also relies on the testimony of PostCom witness

Lubenow (PostCom et al. -T-3). Mr Lubenow establishes that mailer undertakings to improve the quality of lists used to address mailpieces yield cost savings to the Postal Service in addition to the narrowly defined basis for calculating the Standard A automation discounts.

Mr. Glick's presentation contains the only express presentation by any PostCom witness for rates different from those proposed by Postal Services; he proposes a one hundred percent pass through of the cost savings to the Postal Service when Standard (A) mail is drop shipped, increasing drop shipping discounts from the roughly seventy-five percent passthrough proposed by the Postal Service. The testimony of Joseph E. Schick (PostCom et al. -T-2) demonstrates that, even with the passthrough of one hundred percent of Postal Service measured drop shipment cost savings, the Postal Service will benefit from cost savings incidental to drop shipment (but not measured by the Postal Service) in the form of the increased delivery of Standard (A) mail on pallets, rather than in sacks or gaylords. Thus, in practical effect, Mr. Glick's proposal does not pass through one hundred percent of the cost savings associated with drop shipment even though he does increase the Standard (A) drop shipment discounts above the level proposed by the Postal Service.

We outline the testimony of each of these four witnesses sponsored by PostCom in somewhat more detail in what follows.

I. The Revenue Requirement Is Considerably Overstated.

Mr. Buc isolates three independent reasons for concluding that the revenue requirement advanced by the Postal Service is too large. He

establishes that the 2.5% (of total cost) contingency fund requested by the Postal Service should be set at 1.0% of the total cost, resulting in a downward adjustment of the revenue requirement of 1,010,788 thousand dollars. He demonstrates that the correct application of an improvement in the Postal Service's roll-forward procedures recognized by the Commission in R97-1 leads to a downward revenue requirement adjustment of 92,943 thousand dollars. And he establishes that the Postal Service has underestimated the cost reductions in the Test Year that will result from AFSM 100 deployment. Properly measuring these reductions will yield savings 199,933 thousand dollars greater than those estimated by Postal Service.

(A) A 2.5% Contingency Fund Is Unwarranted

Mr. Buc's testimony recognizes that some "reasonable provision for contingency" is not only statutorily sanctioned, 39 U.S.C. § 3621, but a necessary break-even bulwark against the uncertainties of the rate making process. That does not mean that any contingency fund thought appropriate by Postal Service management must or should be approved by the Commission. The exercise of marking the boundaries of contingency funds that are reasonable and those that are not necessarily has a predictive and, to some extent, subjective component to it. Mr. Buc recognizes that the variance analysis that has matured out of PRC decisions, the equity position of the Postal Service at the time of filing a rate case or the various measures of general tendencies of the economy as a whole are not definitive measures of the permissible size of the contingency fund. He does

show, however, that each of these factors cautions in favor of a contingency fund substantially smaller than that requested by the Postal Service. DMA-T-1, 13-16.

To supplement this analysis (and give the recognition due to the subjective element of contingency fund analysis) Mr. Buc examines the rationale advanced by the Postal Service through witness Tayman (USPS-T-9) for the contingency fund requested. To appreciate Mr. Buc's point, it is well to note that the term "contingency fund" has consistently been read by the Commission, as Mr. Buc's review of the last eight omnibus rate cases establishes, id. at 3-9, to apply only to unexpected contingencies, events that have not been, and cannot have been, anticipated in other rate design elements. Mr. Buc demonstrates that the first three justifications offered by witness Tayman have already been accounted for in the Postal Service's roll-forward model. Id. at 12. The Postal Service's witness Tolley took account of the factors underlying witness Tayman's fourth justification for the requested contingency. Id. The last of Mr. Tayman's justifications for the requested contingency fund level is a matter that is not in the least unforeseeable or uncertain. Id. at 13.

Neither the empirical guides that the Commission has customarily employed to analyze the reasonableness of contingency fund requests nor the express rationalization for that request justifies it. Mr. Buc argues persuasively that a contingency fund of 1% of total costs is appropriate. Id. at 17.

(B) The Postal Service Continues To Overstate The Costs Of Supervisors In Its Roll Forward Analysis

In R97-1 Mr. Buc presented testimony showing that when the costs for clerks and mailhandlers in the Test Year are reduced below their Base Year levels, supervisory costs ought to be commensurately reduced. The Commission accepted this analysis. Id. at 17-18. In this proceeding, Mr. Buc demonstrates that a comparable adjustment is also required; this adjustment results in savings of \$93 million in the Test Year. Id. at 18-19.

(C) The Postal Service Will recognize Greater Than Estimated Savings From Its AFSM 100 Program.

Witness Buc recapitulates the Postal Service's estimations of cost savings from its AFSM 100 program as follows:

Program	Number of Machines	Workhour Savings per Machine	Total Workhour Savings	Cost Savings (\$ dollars)
AFSM	173	2,500	2,715,000	76,070,000
Accelerate AFSM Buy	44	29,727.3	1,308,000	36,648,000
AFSM to Upper Bound	44	43,181.8	1,900,000	53,235,000

Id. at 20,21. Noting that "witness Tayman's . . . [first 173 AFSM] cost savings per machine are very low compared to the other two programs . . .," id. at 21, Mr. Buc independently analyzed the workhour savings for the first 173 AFSM machines to be purchased. As he explains in his testimony, his estimation is conservative in that it relies on information provided by the Postal Service and ignores certain additional savings that are very likely to accrue. Id. at 22. By

Mr. Buc's calculation, the AFSM cost savings in the Test Year will be almost 200 million dollars greater than projected by the Postal Service.

(D) Recapitulation

On the strength of Mr. Buc's three demonstrations of revenue requirement overstatements, the revenue requirement should be reduced by 1,303,665 thousand dollars. Id. at 1.

II. The Postal Service Has Understated the Cost Savings For Processing Standard (A) Automation Flats.

Sander Glick demonstrates that the Postal Service has rather substantially understated the automation program-related cost savings in the processing of Standard (A) flats that will occur in the Test Year. In order to determine cost savings that are related to the automation program, one must compare the cost of processing nonautomation Standard (A) flats with the cost of processing automation Standard (A) flats. The Postal Service makes two mistakes in the first step of this analysis. The costs associated with processing nonbarcoded flats are understated because the "accept rates" for this mail on FSM 881s are overstated as are FSM 1000 keying productivities. The Postal Service proceeds to make two more mistakes in the second analytic step. It fails to reflect that the Postal Service employees involved in processing barcoded flats are in lower wage groups than clerks more likely to be employed in handling nonbarcoded flats. It also understates the extent to which Standard (A) flats in the Test Year will be sorted by machines rather than manually. Taken together, these four mistakes result in an understatement of the processing cost differences between

Standard (A) nonautomation and automation flats of just under 1.6 cents per piece for basic automation pieces and just below .8 cents for 3/5 automation pieces.

(A) Accept Rates

The first understatement of costs associated with nonautomated Standard (A) flats results from an over-estimation of the efficiency of the FSM 881 when operating in the OCR mode to process nonbarcoded Standard (A) flats. This is reflected in what the Postal Service refers to as an "accept rate". It was estimated at 80 to 90 percent for the FSM 881 processing nonbarcoded flats. Mr. Glick demonstrates that an accept rate of 75 percent is more realistic, increasing the cost differential between nonbarcoded and barcoded Standard (A) flats. PostCom et al. T-1, 9.

(B) The FSM 1000 Is More Productive In BCR Operations Than Keying Operations

The Postal Service flats cost model assumes that the FSM 1000 is equally efficient when engaged in keying operations as in BCR operations. This is clearly wrong and the data resulting from this assumption are anomalous. Id. at 13-14. Mr. Glick makes a more reasonable assumption that FSM 1000 keying productivities are the same as FSM 881 keying productivities and adjusts the product of the flats cost model accordingly. Id. at 13-14.

(C) Applicable Labor Rates

Automation flats are more likely to be handled on automated equipment than nonautomation flats. Automation equipment is staffed primarily by PS-04

and casual clerks. The clerks more likely to be involved in handling nonautomation flats are PS-05 or PS-06 clerks. Id. at 9. The Postal Service's flats cost model makes no such differentiation, so Mr. Glick, in performing his calculation of costs, made adjustments appropriate to reflect these facts. Id. at 9-10.

(D) Economies Of Machine Sortation

Automation flats are sometimes manually sorted, rather than being sorted by machine. There are very significant cost consequences associated with this fact. As Mr. Glick testifies, the cost of a manual incoming secondary sort of a flat is 4 cents while the cost of the same sort on an AFSM 100 is approximately 1 cent. Id. at 8n. 4. Thus, the accurate projection of the relative proportion of manually handled and machine sorted automation flats in the Test Year is very important. The Postal Service flats cost model projects that only 50 percent of the automation flats that in all other regards qualify for automated rather than manual handling will receive an automated incoming secondary sort in the Test Year. Id. at 10-11. By Mr. Glick's calculation there is no reason for this. There will be more than enough machine capability in the Test Year to provide more automated sorts. Id. at 12. There is no other sound reason that a higher proportion of automated flats should not (and will not) receive automated incoming secondary sortations in the Test Year. Id. at 13. Mr. Glick projects that 70 percent machine incoming secondary sortation is a more sensible projection than 50 percent and he has run a revised flats cost model with this assumption. Id. at 11.

(E) The Results of These Adjustments

As Mr. Glick testifies, id. at 15, the savings differences between the PostCom flats cost model and the USPS version of that model are 1.595 cents per piece between basic nonautomation flats and basic automation flats and .778 cents per piece between 3/5 nonautomation flats and 3/5 automation flats.

(F) Additional Non-monitized Automation Savings.

As Joe Lubenow explains in his PostCom-sponsored testimony “if the universe of automation mail is compared to the universe of nonautomation mail, the costs savings [from automation] are greater than just the direct savings in operations from mailer prebarcoding that the USPS identifies.” PostCom et al.-T-3, 5. Although Mr. Lubenow does not expressly request changes in the rates proposed by the Postal Service, he explains the costs incurred by mailers to improve address quality, id. at 9-19 and the harms to the Postal Service when mailers decline to incur those costs, id. at 20-22, and suggests some variations in rate design that would help to improve address quality. Id. at 23-25.

III. The Drop Shipment Discounts For Standard (A) Mail Should Be Increased.

In the only piece of PostCom-sponsored testimony that argues for alterations in the rates proposed by the Postal Service, Sander Glick urges “100 percent passthroughs of all destination entry cost savings” PostCom et al. – T-1,2. Mr. Glick supports this position on the basis of economic theory, id. at 3,

and Commission precedent. id. at 3-5. The rates that would result from Mr. Glick's proposal are set out at PostCom et al. -T-1, 6.

Joseph E. Schick adds a rationale for Mr. Glick's drop shipment discount proposal. Drop shipped mail tends to be more highly palletized than locally entered mail. PostCom et al. -T-2, 3-5. As Mr. Schick demonstrates, this has considerable advantages for the Postal Service. Id. at 6-7.

These considerations, when coupled with those of Mr. Glick, argue forcefully for a one hundred percent passthrough of the savings associated with the drop shipment of Standard (A) mail.

CONCLUSION

With the one exception addressed immediately above, the rates proposed by the Postal Service should be recommended by the Commission.

Respectfully submitted,



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CERTIFICATION

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the rules of practice.


Ian Volner